FFA Private Bank s.a.l

Lebanese Banks	Bank Audi (AUDI LB)	MARKETWEIGHT	USD 7.00
Equity Research	Blom Bank (BLOM LB)	OVERWEIGHT	USD 10.00
September 26th, 2012	Byblos Bank (BYB LB)	MARKETWEIGHT	USD 1.60

Expect no major catalysts that could drive shares higher on account of weakened investor appetite and slower earnings momentum

- The Lebanese banking sector seemed to hold up well in H1/12 despite sluggish economic conditions on the local scene and impact from the Syrian unrest. Key activity growth indicators continued to report decent performance with assets, deposits and loans growing at a respective 4%, 4% and 6% Ytd in H1/12. In our coverage universe, Bank Audi, Blom Bank and Byblos Bank saw their deposit base grow by a respective 0%, 3%, 4 % and their loan portfolio grow by 6%, 4%, 2% respectively.

- Following a movement initiated in 2011, Lebanese banks' profits trended flat in H1/12 which we expect to continue for the remainder of the year. This weaker momentum could be attributed to i) pressured margins from declining yields on Lebanese securities along with a limited capacity to further decrease the cost of funds ii) higher provisions as measures facing developments in Syria and iii) slowing growth in fees and commissions. In our coverage universe, Bank Audi, Blom Bank and Byblos Bank reported earnings growth rates at respective 6% (excluding the sale of LIA), 1% and 0% YoY in H1/12.

- The asset quality of Lebanese banks is being impacted by some deterioration in Syria while it remained largely contained domestically. Furthermore the smaller share of the Syrian loan portfolio in the consolidated loan book has moderated the impact on asset quality. The NPL/net loans ratio for the sector dropped to 3.8% in 2011 according to the ABL. Blom Bank and Byblos Bank saw their gross NPL ratio increasing to a respective 3.95% and 3.94% in H1/12 while Bank Audi maintained it at 2.9% and displayed the highest coverage ratio according to our estimates.

- Healthy liquidity and comfortable capitalization levels continued to buffer the banking system with an LDR at 35% at the end of June 2012 and a CAR II ratio exceeding 12%. At end-June 2012, Bank Audi, Blom Bank and Byblos Bank reported CAR III ratios at a respective 12.2%, 13% and 13.3% which are viewed as comfortable levels bearing in mind the 12% set as an objective by the BDL and the BCC by the end of 2015 and the 10.5% set by the Basel committee as a requirement before 2019.

FFA Private Bank Lebanese Banks Coverage

Company	Ticker	Recommendation	Target Price	Priced as of September 26, 2012	P/E	P/B	Dividend Yield
Bank Audi	AUDI.LB	Marketweight	USD 7.00	USD 5.50	5.4x	0.91x	7.3%
Blom Bank	BLOM.LB	Overweight	USD 10.00	USD 7.40	4.9x	0.91x	6.1%
Byblos Bank	BYB.LB	Marketweight	USD 1.60	USD 1.49	6.3x	0.78x	8.9%

Source: BSE, FFA Private Bank estimates; Note: Figures for Bank Audi exclude the sale of LIA

- While lower share prices have brought bank shares to more attractive valuation levels, we see no major catalyst in the short term that could drive shares higher as earnings are expected to remain lackluster amidst weakened investor appetite and challenging operating conditions. We continue to value banks' ability in reporting moderate balance sheet growth within less favorable macro dynamics, coping with the pressures on earnings generation while adopting prudent provisioning measures.

- We lowered our target prices on Bank Audi, Blom Bank and Byblos Bank reflecting downward revisions on our earnings estimates and increased cost of equity assumptions. We maintained our recommendations unchanged for the three banks although encouraged by Bank Audi's recent performance in seeing earnings growth and preserving asset quality compared to the sector, improving visibility in Egypt and growth expansion strategy including the branch roll out in Turkey.

- **We are Overweight on Shares of Blom Bank (TP USD 10.00) and Marketweight on Shares of Bank Audi (TP USD 7.00) and Marketweight on Shares of Byblos Bank (TP USD 1.60)**

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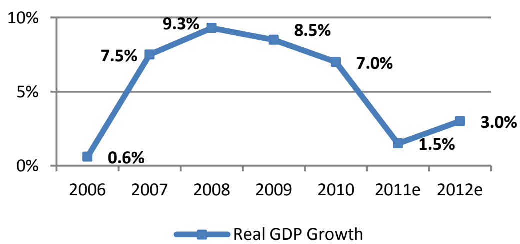
LEBANESE ECONOMY–First Half of 2012 Performance

■ In light of a decline in confidence, economic conditions continued to be soft in the first half of 2012

In the first half of 2012, economic developments continued to be soft amid a decline in confidence due to political uncertainties given the regional political and security turmoil and rising concerns from possible Syrian turmoil spillover effects. After economic growth slowed in 2011 with a real GDP growth rate at an estimated 1.5% down from 7% in 2010 according to the IMF, forecasts for 2012e stand at 3% (revised downward from 3.5% previously) suggesting a continued softness in the economic situation. The Central Bank of Lebanon governor expects activity to trend between 2% and 3%.

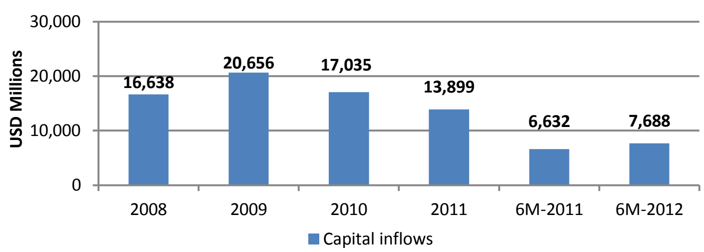
Some economic indicators highlight a relative regain of momentum in the first months of 2012 compared to the corresponding period of previous year, suggesting the Lebanese economy' traditional ability to weather an overall uncertain political climate. The value of cleared checks in the banking system, a coincident indicator of overall consumption and investment patterns in the economy, pointed to an increase in spending levels during the first six months of 2012 as the value of total cleared checks rose by a yearly 2 percent during the first half of this year to roughly USD 35 billion. More notably, capital inflows into Lebanon (a driving force for the Lebanese economy) regained some momentum in the first half of 2012 up 16% to USD 7.7 billion from USD 6.6 billion in the corresponding period of previous year after a significant decline to 14 billion in 2011 from USD 17 billion in 2010. As for the trade activity, Lebanon's imports up to June of this year rose 18% to reach USD 10.9 billion, compared with USD 9.2 billion in the same period of 2011, from higher energy import prices translating into aggravated trade deficit by 22.6% YoY as exports increased 3% to USD 2.2 billion, compared with USD 2.1 billion in the same period of last year.

Figure 1: Real GDP growth



Source: IMF

Figure 2: Capital inflows



Source: BDL

However, sluggishness remained a main characteristic of the overall macroeconomic environment. On one hand, the most recently published Central Bank's monthly Coincident Indicator, a measure of the overall macro environment, decreased by 2% MoM in June 2012 to 261.8 points and stagnated YoY. In parallel there was a continued deceleration in the performance of some key sectors of the Lebanese economy (including tourism and real estate representing a combined 35% of Lebanon's GDP) which started seeing weaker conditions in 2011. Tourism continued to decline in 2012 as the official released figures showed that Lebanon saw an approximate 8 percent drop in tourist arrivals during the first half of 2012 to 713,919 compared to the corresponding period of 2011. However, it could be noted that over the same period number of passengers' arrivals at the Beirut Airport picked up 12% YoY to 1,397 thousand suggesting a higher influx of Lebanese expatriates. As for real estate market, it pursued its slowdown as property sales in number terms were 8% lower in the first half of 2012 compared to the corresponding period of the previous year, reflecting decreasing demand levels.

■ The outlook remains highly tied to political uncertainties

Overall, the economic situation remains fragile amid rising concerns due to possible spillover effects from Syria following recent security events. In sum, 2012 is not shaping to look much different than last year as the health of the Lebanese economy, including its capacity to attract capital and tourists, will remain closely linked to political uncertainties. The overall economic sentiment is expected to remain on a wait and see mode due to the fact that the country is still facing considerable challenges ahead as the prospects for a near term resolution in Syria are low, the fears regarding the Syrian's unrest spilling over into Lebanon are rising, the Special Tribunal for Lebanon carries its investigation into the assassination of the former Prime Minister Rafik Hariri into the next years, and the country is heading towards parliamentary elections in 2013e. In this context, some international agencies revised their outlook for GDP growth in 2012 downward: The Institute of International Finance projected Lebanon's real GDP growth rate at 1.2% in 2012 down from a range of 2.1%-3% attributing it to the continuing negative impact of the Syrian conflict on economic activity. In addition, BMI revised downward its projection for Lebanon real GDP growth to 1.6% in 2012 from a previous forecast of 2.8%, as it mentioned the security and political vulnerability as well as the higher oil prices and its adverse effect on Lebanon's growth outlook.

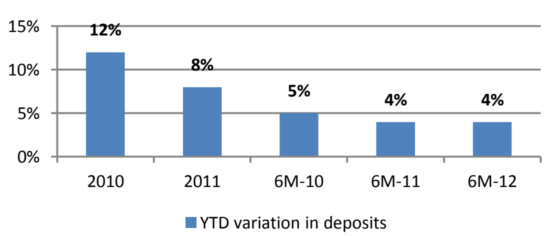
LEBANESE BANKING SECTOR – First Half of 2012 Performance

■ Balance sheet activity continued to report moderate growth weathering a challenging operating environment from soft economic conditions and regional instability

The Lebanese banking sector, which represents a significant drive for economic growth, seemed to hold up well in H1/2012 despite the sluggish economic conditions on the local scene and the Syrian unrest. Key activity growth indicators continued to report decent growth despite a slight deceleration compared to the previous year.

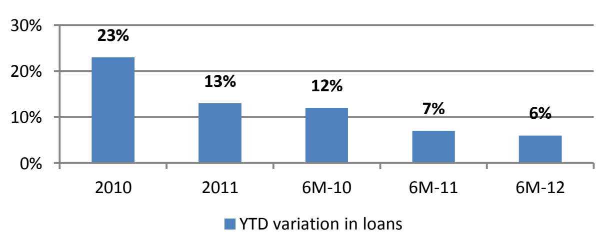
Assets of commercial banks remained mainly driven by deposits, which accounted for nearly 80% of total assets at end-June 2012. The asset base reached USD 145.9 billion at end-June 2012, up 4% from end-2011 (slightly lower than the 5% increase in the corresponding period of previous year). Deposits reached USD 120 billion at end-June 2012, up 4% from end-2011 (equivalent to the 4% increase in the corresponding period of previous year), in line with the Central Bank Governor's expectation for a deposits growth rate at 8% for the full year 2012. Resident deposits accounted for nearly 75% of the deposit growth in H1/12, with the remainder (25%) attributed to non-resident deposits. The dollarization rate of deposits edged down slightly to 65% at end-June 2012 down from 65.9% at end 2011 suggesting a favorable depositors' appetite for holdings in local currency, yet remains higher than the de-dollarization record of 63% reached in 2010.

Figure 3: YTD variations in deposits in commercial banks



Source: Banque du Liban

Figure 4: YTD variations in loans to residents and non-residents



Source: Banque du Liban

Lending activity to the private sector remained healthy. Loans to the private sector totaled USD 41.7 billion at end-June 2012, 5.9% up from end-2011 and slightly lower than the 6.7% increase in the corresponding period of previous year. The year-to-date growth in lending volumes stand at USD 2.3 billion of which 84% were allocated to the resident sector. The dollarization of loans stood at 78.1% at end-June 2012 compared to 78.4% in at end-December 2011, suggesting that it is continuing to decline at a slow and gradual pace which could partly explained by BDL measures to encourage lending in local currency mitigated by more attractive risk-adjusted returns on lending in USD given the higher spreads and more dollarized banking sector.

■ More than 75% of loans are allocated to retail and the exposure to the property market remained contained

Based on data provided by the Central Bank, the breakdown of loans by sector for 2011 shows that the bulk of the loan book for the financial sector is made up of retail loans. The figures indicate that loans to the private sector include 78% of retail loans and the virtual remainder in corporate loans with trade and services sectors as the largest beneficiaries. Taking a closer look at the exposure of the financial sector to the property market, we note that loans for construction, housing and rent totaled USD 16.4 billion at end-2011 up from USD 13.6 billion at end-2010, an approximate 20% increase whereas total credits grew by roughly 13% in the same period. While this trend could give rise to concern given the current slowdown in the real estate market, we believe this risk to be somewhat mitigated by the marginal size of this exposure when taking into consideration the large asset base of the banking sector, the relative small share of loans in the sector's assets, as well as by the practices of regulatory authorities to help shield banks from any marked deterioration in their asset quality. One of the main regulations that should be cited in this respect is the 60% limit imposed on developers with regard to the leverage of real estate projects.

■ Banking sector's profits trending flat in 2012 on account of tightening margins, higher provisions against operations in Syria, slower fee income growth and moderate balance sheet expansion

After reporting double-digit growth in earnings from 2005 to 2010, Lebanese banks' profits declined by 3% in 2011 to end the year at USD 1.6 billion. This slowdown in earnings continued to be felt in 2012. In fact, the financial results at end-June 2012 show that the combined profits of the five banks listed on the Beirut Stock Exchange (including Bank Audi, Blom Bank, Byblos Bank, Bank of Beirut and BEMO) reached USD 484 million in the first half of 2012, edging up 1.3% from USD 477.8 million in the corresponding period of last year. Central Bank Governor Riad Salameh expects the consolidated profits of Lebanese banks to stagnate or to witness a slight drop in 2012.

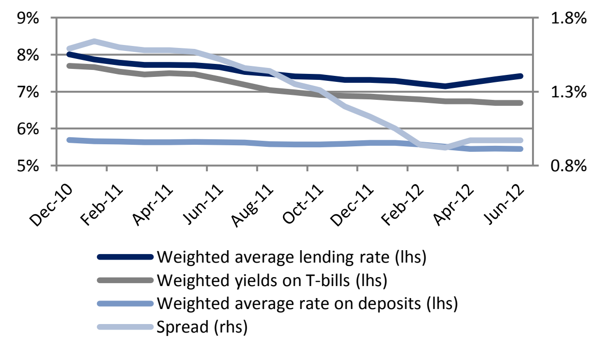
The weaker earnings momentum could be attributed to tightening margins and higher level of provisioning as measures are taken against rising uncertainties in Syria despite a continuous improvement in cost-efficiencies. Furthermore, moderate balance sheet expansion is slowing the growth of fees and commissions which in turn is pressuring earnings generation.

■ Tight margins expected to apply further pressure on banks' earnings

In the context of moderate balance sheet expansion, net interest income (a major component of bank's operating income) is being pressured by tightening interest margins. In fact, Lebanese banks are dealing with declining yields on Lebanese securities, along with a limited capacity to further decrease the cost of funds.

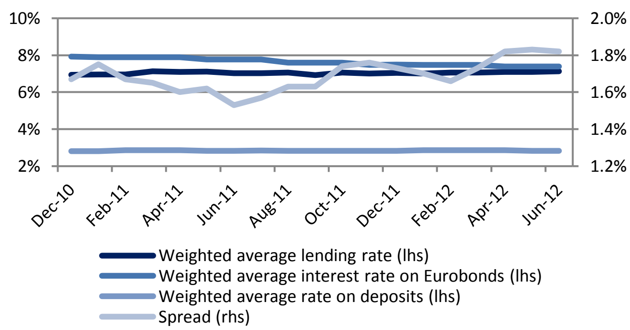
After a steady decline in interest rate on deposits in order to maintain their margins and their profitability levels, Lebanese banks have maintained strict control on deposits rates during 2012 in an attempt to offset i) interest margin pressures on the back of less attractive asset yields and ii) soft balance sheet growth. According to the ABL, interest rates on deposits in local currency continued to decline from 5.61% in December 2011 to 5.45% in June 2012, while interest rates on deposits in foreign currency were maintained at 2.82% over the same period. Declining yields on treasury bills from 6.87% in December 2011 down to 6.69% in June 2012 have exerted pressures on LBP interest spreads throughout 2011 and in the first half of 2012. Interest spreads in local currency tightened to 0.97% in June 2012 down from 1.13% in December 2011 while spreads in foreign currency reached 1.82% in June 2012, higher than 1.73% in December 2011 despite a decline in Eurobonds from 7.49% in December 2011 to 7.39% in June 2012 explained by higher lending rates in FC reaching 7.12% in June 2012 up from 7.04% in December 2011.

Figure 5: Interest spreads in LBP



Source: ABL

Figure 6: Interest spreads in USD



Source: ABL

CDs issued by the BDL offer higher yields than treasury bills and could be considered as an attractive risk/reward avenue for the liquidity of Lebanese banks. In fact the weighted average rate on CDs in LBP issued by the BDL was at 9.27% in June 2012 higher than the weighted yield on treasury bills at 6.69% in June 2012. However, we still believe that Lebanese banks could benefit from gradually higher yields on treasury bills which would make them more attractive, to avoid increasing pressures on the cost of funds which are already relatively low and could in turn negatively impact deposits inflows into the Lebanese banking system. As a step taken by the Government to offer more attractive rates, the Ministry of Finance is issuing treasuries with longer maturities at higher yields.

Lebanese banks maintain solid capitalization and ample liquidity levels into June 2012

Lebanese banks have traditionally operated with solid capital ratios and banks have further strengthened their capital base during past years by issuing common and preferred shares. Looking at the figures we note that the equity-to-assets ratio of commercial banks increased to 8.1% in June 2012 from 7.6% at year-end 2011. In its annual report for 2011, the ABL indicates that the Lebanese banking sector boasts a capital adequacy ratio exceeding 12% on a Basel II basis.

It is expected that Lebanese banks will comfortably adapt to the Basel III capitalization requirements as regulatory authorities strictly monitor the transition process. Currently banks are preparing to meet Basel III requirements with 12% as an objective for total capital adequacy ratio by the end of 2015, while the Basel committee sets 10.5% (8%+2.5% conservation buffer) as a requirement before 2019. Lebanese banks have most of the regulatory capital tied in Tier 1 which provides them additional capacity compared to MENA peers when banks need to apply the more restrictive capital definitions into 2019.

Furthermore, we note the ample liquidity levels of Lebanese banks which rank highly against regional and global benchmarks which buffer the banking industry in times of financial distress and global economic downturns. On one hand Lebanese banks enjoy a large deposit base accounting for approximately 80% of total assets in June 2012. On another hand, the loans-to-deposits ratio for Lebanese banks is considered quite low at 35% in June 2012.

Sector's NPLs impacted by regional operations and exposure to the sovereign contained at roughly 54%

Since the beginning of 2011, the credit quality of Lebanese banks has been negatively impacted by political developments in some regional countries of operations including Syria and Egypt. Domestically, the asset quality remained largely contained despite weaker economic environment, backed by the Lebanese banks' conservative lending policies and practices as well as by the Central Bank's supervision. On a consolidated level, figures released by the ABL highlight that the ratio of NPLs/Net total loans dropped to 3.8% in 2011. In parallel the provision coverage (provisions against NPLs/NPLs) remained roughly stable at 60.1%.

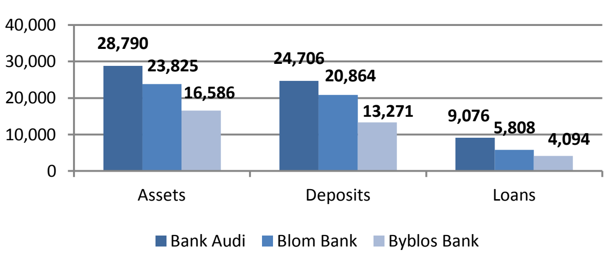
We also note a contained exposure to the sovereign at roughly 54% at year-end 2011 reflecting the share of Lebanese banks assets which are made up of government securities and Central Bank papers. The high exposure of banks to the sovereign remains a main area of concern given the high debt and the fiscal imbalances of the public sector, yet this risk is somewhat mitigated by the fact that much of the debt is held domestically and the government has never defaulted despite its numerous shocks. The Lebanese banking sector has traditionally acted as the backbone of the economy, financing the government by attracting customer deposits and investing in sovereign securities.

BANKS UNDER COVERAGE – First Half of 2012 Performance

Banks under coverage witnessed moderate growth in deposits and loans in H1/12

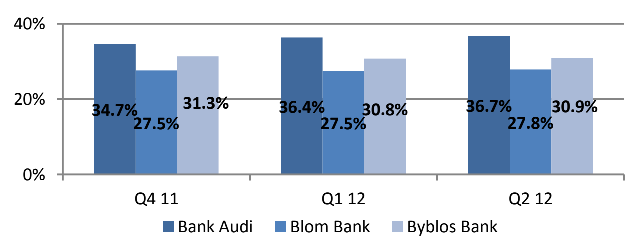
Two of the Banks under coverage (namely Blom Bank and Byblos Bank) saw moderate growth in deposits and loans in H1/12, at 3% and 4% respectively for deposits and 4% and 2% for loans respectively; in contrast to flat performance for Bank Audi in terms of deposits growth although outpaced its peers in loans growth at 6% over the same period. The majority of assets were funded by deposits: 86%, 88% and 80% for Bank Audi, Blom Bank and Byblos Bank respectively, consequently balance sheet growth followed in parallel to deposits for Bank Audi and Blom Bank, with the exception of Byblos Bank whose assets stagnated YTD in H1/12. With an asset base of roughly USD 29 billion, a deposit base of USD 25 billion and a loan portfolio slightly exceeding USD 9 billion, Bank Audi comfortably leads the sector market share at end-June 2012, followed by Blom Bank. As for Byblos Bank it held the third largest market share in terms of assets and deposits as at end-June 2012.

Figure 7: Assets, deposits and loans at end-June 2012(in USD millions)



Source: Company reports

Figure 8: Loans-to-deposits ratio



Source: Company reports

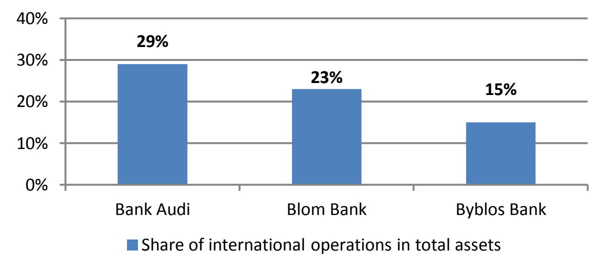
The Lebanese banking sector boasts a loans-to-deposits ratio at 35% at the end of June 2012, slightly up from 34% at year-end 2011 and reflecting a comfortable level of liquidity which could be redeployed into attractive avenues on an improving macro and political environment. The three banks under coverage remained highly liquid at end H1/12 with a loans-to-deposits ratio at less than 37% (36.7% for Bank Audi, 27.8% for Blom Bank and 30.9% for Byblos Bank). In 2012, we expect banks under coverage to continue witnessing moderate deposit growth ending the year at mid to high single digit and to remain supported by higher capital inflows compared to last year despite continuous pressures from deposit outflows in Syrian entities. We see lending momentum remaining healthy in

2012e as Lebanese banks continue to channel some of their liquidity towards the private sector to offset falling yields on Lebanese securities particularly on treasuries. On the longer term, banks could benefit from improved visibility on regional operations and material reacceleration in domestic economic activity lending activity.

■ Bank Audi boasts the most diversified asset base across markets and the lowest exposure to the Lebanese sovereign in our coverage universe

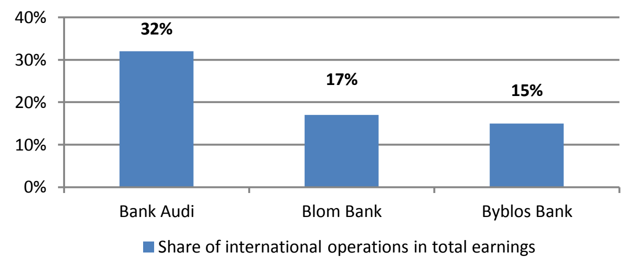
The breakdown of assets between domestic and international operations as of June 2012 reveals a structure of 71%/29%, 77%/23% and 85%/15% for Bank Audi, Blom Bank and Byblos Bank respectively highlighting that Bank Audi boasts the most diversified asset base across markets in our coverage universe. The breakdown of earnings between domestic and international operations at end-June 2012 highlight that Bank Audi also leads our coverage universe in terms of earnings' diversification across markets with 32% of earnings generated from international operations (excluding profits from as compared to 17% and 15% for Blom Bank and Byblos Bank respectively.

Figure 9: Share of international operations in consolidated assets



Source: Company reports

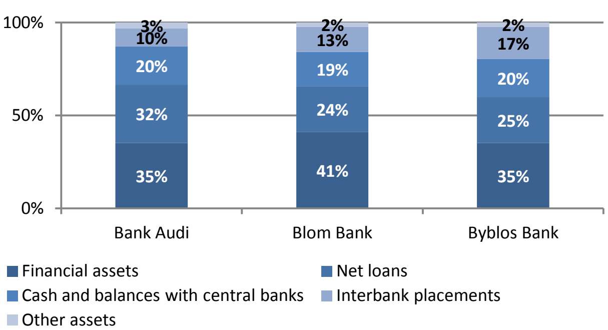
Figure 10: Share of international operations in consolidated profits



Source: Company reports

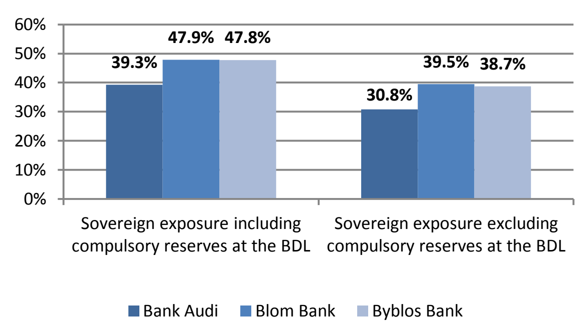
The asset breakdown of banks under coverage reflects an allocation to loans to the private sector at 32%, 24% and 25% for Bank Audi, Blom Bank and Byblos Bank respectively as well as a substantial allocation in financial assets at a respective 35%, 41% and 35% for Bank Audi, Blom Bank and Byblos Bank. The remainder of assets is made up of cash and balances with central banks and interbank placements. In our coverage universe, Bank Audi has the lowest exposure to sovereign risk. At the end of June 2012, the exposure of banks under coverage to the Lebanese sovereign securities (including treasuries, Eurobonds and Central banks' cash deposits, CDs and reserves) stood at 39.3%, 47.9% and 47.8% respectively for Bank Audi, Blom Bank and Byblos Bank, and at 30.8%, 39.5%, 38.7% for the three banks respectively when excluding compulsory reserves.

Figure 11: Assets breakdown at end-June 2012



Source: Company reports

Figure 12: Sovereign exposure at end-June 2012

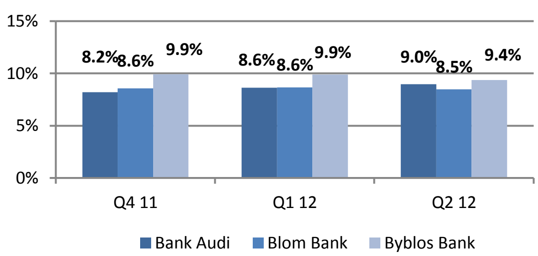


Source: Company reports

Capitalization for banks under coverage supportive of more stringent regulatory capital requirements

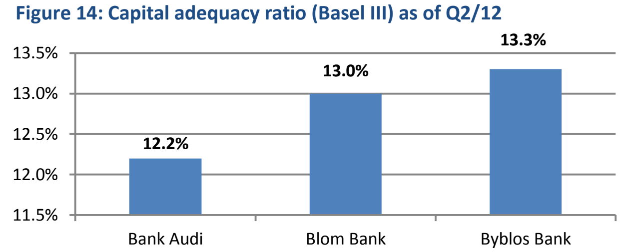
Bank Audi, Blom Bank and Byblos Bank capitalization levels remained sound with an equity-to-assets ratio at over 8% in Q2/12 and a CAR III ratio over 12% at 12.2%, 13% and 13.3% for Bank Audi, Blom Bank and Byblos Bank respectively. It should be noted that Bank Audi saw stronger capitalization levels in Q2/12 with Basel III CAR ratio reaching 12.2% up from 10.7% on account of the increase in capital from the recent series F preferred shares issue and the disinvestment from the insurance business. We expect banks under coverage to continue to strictly monitor their capitalization ahead of more restrictive capital requirements as the Lebanese Central Bank commits to abide by Basel III requirements towards the near end of the 2015-2019 Basel phase-in period.

Figure 13: Equity- to-assets ratio



Source: Company reports

Figure 14: Capital adequacy ratio (Basel III) as of Q2/12



Source: Company reports

In H1/12, consolidated NPLs have generally trended higher in our coverage on account of Syrian operations

NPLs have increased in Syrian subsidiaries given political developments in the country (from 5.6%, 2.7% and 4.3% at year-end 2011 to 13.1%, 8.4% and 19.2% at end-June 2012 for Bank Audi, Blom Bank and Byblos Bank respectively) , yet the smaller share of these loans in the consolidated loan book has moderated the impact on overall asset quality. In fact, following currency devaluation and continued operational decrease in the size of Bank Audi, Blom Bank and Byblos Bank loan book in Syria, the share of these loans in their consolidated loan portfolio has fallen from a respective 6%, 7% and 11% respectively in 2011 to a respective 4%, 4% and 7% in June 2012.

At a consolidated level, Banks under coverage saw some deterioration in their non-performing loan levels into 2011 and 2012. Bank Audi, Blom Bank and Byblos NPLs rose to 2.9%, 3.2% and 3.0% in 2011 from 2.3%, 2.7% and 2.3% respectively in 2010. While Bank Audi managed to maintain its NPLs stable at 2.9% at end-June 2012, Blom Bank and Byblos Bank witnessed a further increase to 3.95% and 3.94% respectively.

Table 1: Consolidated loan quality and provisions as at end-June 2012

In USD millions	Gross Loan portfolio	Gross NPL ratio (%)	Specific provisions	FFA estimated specific coverage ratio (%)	Collective provisions	Total provisions	FFA estimated total coverage ratio (%)
Bank Audi	9,379	2.9%	176	64.7%	89	265	97.4%
Blom Bank	6,073	3.95%	142	59.2%	86	228	95.0%
Byblos Bank	4,284	3.94%	75	44.4%	69	144	85.3%

Source: Company reports, FFA Private Bank estimates

At the same time, banks have been adopting conservative risk practices regarding their regional operations by setting aside income into added collective provisions. Bank Audi leads our coverage universe in terms of provision levels as we estimate the NPL coverage to near 100%, which we view as more than sufficient given relatively low NPLs, followed by Blom Bank and then Byblos Bank.

Table 2: Loan quality and provisions in Syria for banks under coverage as at end-June 2012

In USD millions	Loan portfolio	Gross NPL ratio (%)	Specific provisions	Collective provisions	Total provisions
Bank Audi	345	13.1%	18	18	36
Blom Bank	255	8.4%	5	15	20
Byblos Bank	284	19.2%	16	15	31

Source: Company reports

Table 3: Loan quality and provisions in Egypt for banks under coverage as at end-June 2012

In USD millions	Loan portfolio	Gross NPL ratio (%)	Specific provisions	Collective provisions	Total provisions
Bank Audi	1,450	2.8%	31	6	37
Blom Bank	422	20.4%	78	4	82

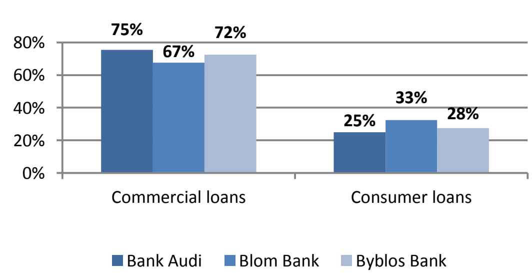
Source: Company reports

While we recognize the potential for a marked deterioration in loan quality from the spillover of political developments in regional countries and the decelerating economy in Lebanon, we note the smaller share of the loan book of regional entities in their consolidated assets particularly as their loans contract namely in Syria, from both operational and currency translation effects.

■ A large majority of loans for banks under coverage are commercial and the share of past due and not impaired loans remains minimal

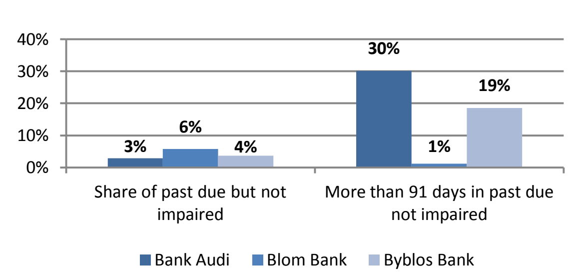
The breakdown of the loan portfolio by client type for the three banks highlights that the bulks of loans to customers are commercial at year-end 2011 (75%, 67% and 72% for Bank Audi, Blom Bank and Byblos Bank respectively). As for the aging of the loan portfolio it reveals that the share of past due not impaired loans is limited for the three banks as it stood at 3%, 6% and 4% at year-end 2011 for Bank Audi, Blom Bank and Byblos Bank respectively. The share of above 91 days in the past due not impaired loans stood at a respective 30%, 1% and 19% for Bank Audi, Blom Bank and Byblos Bank.

Figure 15: Breakdown of loans by type of client at year-end 2011



Source: Company reports

Figure 16: Past due and not impaired loans at year-end 2011



Source: Company reports

■ Net interest income growth impacted from pressures on margins and soft balance sheet growth

After a steady decline in the cost of funds in order to maintain profitability levels, Lebanese banks have maintained strict control on deposits rates during in the first half of 2012 in an attempt to offset i) interest margin pressures on the back of less attractive asset yields , ii) decelerating balance sheet growth, and iii) lower contributions from regional operations.

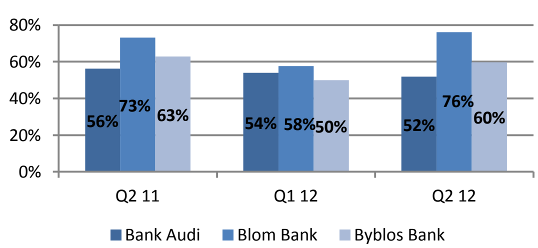
Looking at the net interest income of banks under coverage in H1/12, we notice that growth was healthy for Bank Audi at 9% YoY on margin preservation strategy from a strict control in the cost of funds and moderate for Blom Bank at 4% YoY, while Byblos Bank saw its net interest income decreasing 14% over the same period YoY reflecting pressures on interest margins from lower yields on assets. Bank Audi's spreads totaled 2.09% for the first half of 2012 higher than 1.90% in the first half of 2011, while Blom Bank benefits from the higher margins at 2.24% in H1/12. Byblos Bank's interest margins were at 1.58% in the first half of 2012 down from 1.95% in the first half of 2011.

Going forward we believe net interest income growth will remain moderate on some balance sheet growth and relatively stable interest margins. Banks are focusing on improving earning asset yields by allocating their liquidity into attractive avenues (interesting risk/reward corporate bonds and Central Bank CDs,) to offset tightening yields on Lebanese sovereign bonds and low USD rates in the interbank market as central banks maintain their accommodative policies.

■Non-interest income mainly driven by trading&investment income in H1/12 as fees&commissions slowed

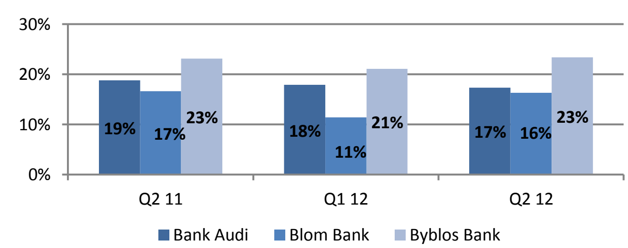
In H1/12, banks under our coverage grew their non-interest income at 22%, 43% and 36% for Bank Audi, Blom Bank and Byblos Bank respectively driving it to a respective USD 254 million, USD 135 million and USD 103 million. This trend was mainly triggered by trading and investment income for the three banks. Banks have been realizing gains on Lebanese securities to help finance increased provisions. Bank Audi, Blom Bank and Byblos Bank saw their trading and investment income surging by 32%, 104% and 90% YoY in H1/12, which contrasted with a moderate growth in fees and commissions at 9% and 5% for Bank Audi and Byblos Bank respectively and a 2% decline for Blom Bank. The slowing fees and commissions momentum is even more evident in Q2/12 as highlighted by stagnation for Blom Bank and Byblos Bank YoY, while Bank Audi continued to report moderate momentum at 8% YoY. Fees and commissions income has likely been slowing on account of weaker trade finance and moderate balance sheet activity.

Figure 17: Net interest income/total operating income



Source: Company reports

Figure 18: Fees and commissions/total operating income



Source: Company reports

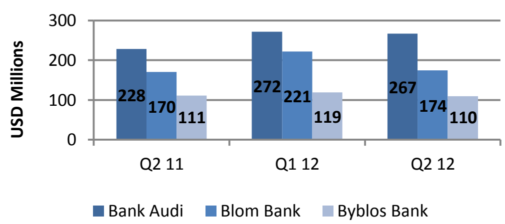
Looking at the revenue mix for H1/12, we note that net interest income accounts for a greater share of Blom Bank's total operating income compared to Bank Audi and Byblos Bank which could be attributed to Blom Bank's higher margins. Net interest income as percentage of total operating income stood at 66% for Blom Bank in H1/12, higher than 53% and 55% for Bank Audi and Byblos Bank respectively.

As for fees and commissions, a resilient part of income, it accounted for 18% and 14% of Bank Audi and Blom Bank operating income in H1/12, while Byblos Bank continue to display the highest contribution of fees and commissions to total operating income in our coverage universe at 22% in H1/12 which we positively value given the less volatile nature of this income stream.

■ Cost-to-income ratio containment is helping to alleviate income headwinds

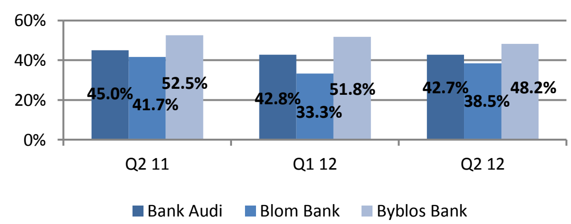
Cost-control measures have generally been trending towards a further improvement for banks under coverage. Blom Bank, which boasts high cost-efficiencies compared to the Alpha Banks average, managed to further decrease its cost-to-income ratio YoY in H1/12 to 35.6% down from 41.2% in H1/11. On the other hand, Bank Audi saw an improvement in its efficiencies as highlighted by the cost-to-income ratio reaching 42.7% in H1/12 down from 45.6% in H1/11, the result of tightening cost-control measures offsetting softer growth in income levels. Byblos Bank, which holds the lowest efficiencies in our coverage universe, maintained its cost-to-income ratio roughly unchanged in H1/12 at 50.1% (vs. 50.6% in H1/11), an improvement in efficiencies can be however noted in Q2/12 with a cost-to-income ratio standing at 48.2% down from 52.5% in Q2/11. This trend of improving efficiencies can be attributed to the control on costs by matching marginal increases in costs with marginal increases in revenues and rationing discretionary expenses.

Figure 19: Operating income



Source: Company reports

Figure 20: Cost-to-income ratio

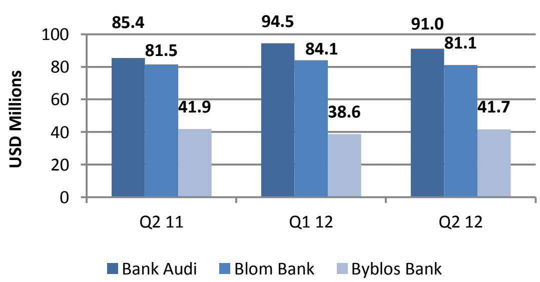


Source: Company reports

■ Bottom line growth stalled in H1/2012 on the back of moderate balance sheet growth, pressured interest margins, weaker fees and commissions and provisioning measures

Bottom line growth for banks under our coverage witnessed weak momentum in the first half of 2012 due to moderate balance sheet growth, pressured interest spreads, weaker fees and commissions, and precautionary provisioning measures, while financial gains and improving efficiencies continued to support earnings. While Blom Bank and Byblos Bank saw roughly flat earnings in H1/12 YoY, Bank Audi registered a 5.5% growth (not taking into account the sale of LIA).

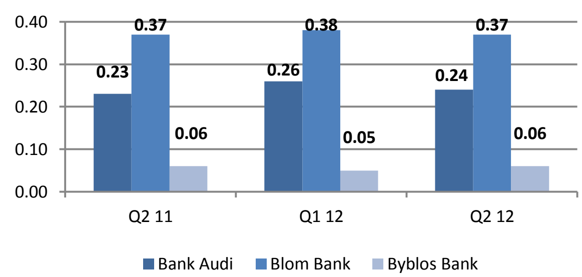
Figure 21: Net profits



Source: Company reports

Note: i) Figures for Bank Audi exclude the result of discontinued operations namely the sale of LIA ii) Bank Audi's Reported net profits for Q2/11 and Q2/12 were USD 89.8 million and USD 135.6 million respectively

Figure 22: EPS (in USD)



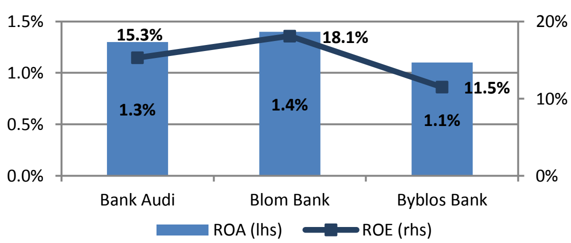
Source: Company reports

Note: i) Figures for Bank Audi exclude the result of discontinued operations namely the sale of LIA ii) Bank Audi's reported EPS for Q2/11 and Q2/12 were USD 0.24 and USD 0.37 respectively

Going forward, we expect bottom line growth to remain lackluster in 2012e, as banks continue witnessing moderate growth in key balance sheet indicators, weaker fees and commissions and pressures on spreads. Yet, it should be noted that banks under our coverage have increased their collective provision levels facing rising uncertainties, which could translate into some additional bottom line improvement should NPL levels not deteriorate significantly from current levels. Also, Lebanese banks as lenders to the government over the years have accumulated unrealized gains in sovereign paper, which could provide additional upside at the detriment of future interest margins. At year-end 2011, Bank Audi, Blom Bank and Byblos Bank had accumulated around USD 200 million, USD 500 million and USD 250 million unrealized gains on their financial assets representing around 20 %, 69% and 53% respectively of their operating income for 2011. Beyond their maturity, we see concern for tighter margins as debt is rolled over at less attractive rates.

The profitability of banks under coverage suggests that Blom Bank boasts the highest profitability ratio in our universe with ROA and ROE at a respective 1.4% and 18.1% in Q2/12 followed by Bank Audi at a respective 1.3% and 15.3%, while Byblos Bank has the lowest profitability ratios in our coverage universe at a respective 1.1% and 11.5%.

Figure 23: Estimated ROA and ROE as of Q2/12



Source: Company reports, FFA Private Bank estimates
Note: Figures for Bank Audi at Q2/12 exclude the sale of LIA

Table 4: P/E, P/B and Dividend yields

	Bank Audi	Blom Bank	Byblos Bank
P/E	5.4x	4.9x	6.3x
P/B	0.91x	0.91x	0.78x
Dividend yield	7.3%	6.1%	8.9%

Source: Company reports, FFA Private Bank estimates
Note: i) Figures for Bank Audi exclude the sale of LIA ii) Market close September 26, 2012

Bank Audi, Blom Bank and Byblos Bank are currently trading at USD 5.50, USD 7.40 and USD 1.49 respectively. On a P/E basis, Blom Bank boasts the most attractive valuation with a current P/B at 4.9x compared to 5.4x and 6.3x for Bank Audi and Byblos Bank respectively. On a P/B to common basis, Byblos Bank has the lowest valuation at 0.78x followed by Bank Audi and Blom Bank at 0.91x. The dividend yield stands at 7.3%, 6.1% and 8.9% for Bank Audi, Blom Bank and Byblos Bank respectively, making Bank Audi the most interesting on a dividend yield basis.

■ While lower share prices have brought banks to more attractive valuation levels, we see no major catalyst in the short term that could drive shares higher

Share prices have generally trended lower in our coverage universe in H1/12, translating into more attractive valuation levels

Investor concerns on regional operations and political uncertainty in Lebanon have negatively impacted share price performance leading banks under coverage to trade below their book values on weaker profitability, earnings, and visibility on regional operations. During H1/12, Bank Audi and Byblos Bank share prices decreased by roughly 5% and 9% to USD 5.50 and USD 1.49, while Blom Bank share price maintained roughly stable at USD 7.40. For the Beirut Stock Exchange, activity is down nearly 40% in H1/12 as compared to H1/12 with total trading volume at 30.8 million shares, representing a daily average traded volume of 250,075 shares in amount and an average daily value of USD 1.9 million.

However we expect no catalyst that could drive shares higher in the short term on greater political uncertainties and weakened investor appetite

While lower share prices have brought bank shares to more attractive valuation levels, we see no major catalyst in the short term that could drive shares higher as earnings are expected to remain lackluster amidst weakened investor appetite and challenging operating conditions. We continue to value banks' ability in reporting moderate balance sheet growth within less favorable macro dynamics, coping with the pressures on earnings generation while adopting prudent provisioning measures which could translate into bottom line improvement once deterioration in NPL levels peaks.

We reflected increased risks into our valuation assumptions for Lebanese banks under coverage

We have increased our cost of equity assumptions within our dividend discount model to value Lebanese banks to reflect heightened market and operational risks. While five year Lebanese government credit default swaps have remained virtually unchanged since one year ago at around 450bps benefiting from a sharp drop of approximately 100bps in the past weeks, we note the rising trend over the past year to possibly reflect heightened geopolitical, economic, and fiscal risks in Lebanon. Our cost of equity calculation is derived from spreads of Republic of Lebanon Eurobonds over US treasuries with similar maturities, and adjusted for the dollarization of the banking sector in Lebanon and the contribution from regional operations. This estimated Republic of Lebanon spreads over US treasuries on recent auctions coincides with the 5-year CDS which we then apply a long term US risk free rate of 3.5% (higher than current given the Fed's accommodative policies) as well as an equity risk premium of 7.5% and a beta of one. We have also corroborated our cost of equity using an inflation differential approach. Our cost of equity assumptions increases to 15.5% while the terminal growth rate is kept at 3%.

Target prices were lowered to account for revised earnings estimates and higher cost of equity assumptions, although kept our ratings unchanged for the three banks

We lowered our target price on Blom Bank TP USD 10.00 (from USD 11.00 previously), Bank Audi TP USD 7.00 (from USD 7.50 previously), and Byblos Bank TP USD 1.60 (from USD 1.80 previously) reflecting downward revisions on our earnings estimates and increased cost of equity assumptions. As a result Blom Bank shares are trading at a 26% discount to our USD 10.00 target price which we rate at Overweight. Bank Audi shares are trading at a 21% discount to our USD 7.00 target price which we rate at Marketweight. Byblos Bank shares are trading at a 7% discount to our USD 1.60 target price which we rate at Marketweight.

BANK AUDI

Q2/12 Consolidated Financial Highlights

Bank Audi's net profits from continuing operations (which exclude the majority sale in LIA insurance) amounted to USD 91.0 million in Q2/12 up 7% from USD 85.4 million in Q2/11. Estimated operating EPS was USD 0.24 compared to estimated operating EPS of USD 0.23 in Q2/11. Net profits and EPS (which include the majority sale in LIA insurance) were USD 135.6 million and USD 0.37, respectively. The year on year increase in earnings from continuing operations in Q2/12 over Q2/11 can be attributed to i) robust 17% YoY increase in operating income to USD 267.0 million on the back of 8% growth in net interest income and 29% growth in non-interest income ii) improvement in cost efficiencies with a cost-to-income ratio at 42.7% in Q2/12 down from 45.0% in Q2/11. Higher provisions continued to mostly offset bottom line gains as they increased to USD 36.8 million in Q2/12 from USD 31.2 million in Q1/12 and USD 21.5 million in Q2/11. Income tax rate was also higher YoY at 21.7% versus 18.0% for the corresponding period of previous year. Looking at the first half of 2012, net profits and EPS (excluding the sale of LIA) were at a respective USD 185.5 million and USD 0.50, up 6% from H1/11.

H1/12 Financial Highlights for Operations in Syria and Egypt

In the Syrian market, following a trend initiated in 2011 Bank Audi continued to witness deposit outflows and a slowdown in lending activity in the first half of 2012. Assets, deposits and loans shrunk by roughly 30% in H1/12 totaling USD 0.8 billion, USD 0.7 billion and USD 0.3 billion by the end of June 2012. Net recurrent profits of USD 2.1 million were generated in Syria in H1/12 and were totally allocated into collective provisions translating into roughly nil in net profits, highlighting Management's cautious attitude. Gross doubtful loans (DLs) to gross loans increased in the Syrian entity to 13.1% at end-June 2012 from 5.6% in 2011 which drove specific provisions to USD 18.1 million in H1/2012 from USD 14.2 million at year-end 2011.

In Egypt, balance sheet aggregates growth was soft, yet did not observe any significant declines since the beginning of 2012 despite the political transition and the difficult economic conditions that ensued. Assets and loans increased by 6% and 10% respectively during H1/12 to USD 3.1 billion and USD 1.5 billion by the end of June 2012, while the deposit base shrunk by 5% to USD 2.5 billion. NPL levels improved from end-2011 as gross doubtful loans to gross loans decreased to 2.8% at end-June 2012 down from 3.2% in 2011. Net profits amounted to USD 15.5 million during H1/12 contrasting with virtually no profits in 2011 on account of collective provisioning measures.

Strategy Update

Cautious attitude regarding operations in the MENA region and deployment of a branch network in Turkey

Bank Audi is currently adopting a cautious attitude in certain regional markets in the wake of political developments, in Egypt and particularly in Syria. Despite the contraction in the balance sheet of the Syrian entity, Bank Audi has been protecting its franchise in the market and maintaining its resources, highlighting the unaltered longer term vision for regional operations. Alternatively, Management is focusing its expansion efforts on Turkey where the Bank was granted a license to establish a Bank in October 2011. Bank Audi is targeting a network of 28 branches over 18 months reaching 57 branches in 2016 in Turkey. We view the Turkish market as offering an interesting growth potential given the relative political stability, young population, sizeable domestic market, and potential for trade finance between Turkey and the Arab world.

Ongoing margin preservation strategy amid slower balance sheet growth and less attractive yields on Lebanese securities

To offset slower balance sheet growth and preserve profitability levels, Bank Audi Management has been adopting a margin preservation strategy, targeting 2% in net interest margins. This target was achieved in Q4/11 as Bank Audi spreads totaled 2.08% for the quarter and 1.92% for the full year 2011. Spreads widened by few basis points in 2012 totaling 2.09% for H1/12 higher than 1.90% in H1/11, benefiting from a strict control in the cost of funds along with an improvement in asset yields. In light of less attractive yields on Lebanese securities and restricted room to further decrease the cost of funds, Management will look for attractive avenues to increase the yields on earning assets aiming to further improve interest spreads in 2012.

Cost-control measures aiming to maintain the efficiencies around their current levels

Bank Audi has been working on cost control measures including matching marginal cost increase by marginal increase in revenues, although some investments will be presumably be needed for Turkey as Bank Audi traditionally front loads costs during branch rollouts. It should be noted that Bank Audi has been gradually enhancing its cost-efficiencies during the past couple of years, as witnessed by a regular decrease in its cost-to-income ratio converging towards the 42%-45% range which was targeted by Management as being a sustainable level.

Recent News

July 2012: Bank Audi listed an additional 1.4 million GDRs on the BSE. These GDRs will be added to the previously listed 100.1 million. Total number of shares outstanding stands at 349.4 million.

July 2012: Bank Audi increased its capital through the issuance of 1,500,000 Series F preferred shares. The price of subscription amounted to USD 100 per share. Consequently the capital (and issue premium) made up of preferred shares increased by USD 150 million to USD 400 million at the end of Q2/12 from USD 250 million in the previous quarter.

June 2012: Bank Audi completed the sale of an 81% stake in its insurance arm LIA insurance sal to Saham Finances sa. The gain generated from this transaction totaled USD 44.5 million which drove Bank Audi's net profits in Q2/12 from USD 91.0 million up to USD 135.6 million. The majority sale in the insurance business can be attributed to the fact that regulatory requirements are becoming more stringent on insurance companies owned by banking groups, thus weighing on capital adequacy ratios.

April 2012: For the financial year 2011, Bank Audi paid dividends to the holders of shares with common shareholders receiving LBP 603 per share (USD 0.40 gross or USD 0.38 net of 5% withholding tax).

FFA Model Assumptions

In light of the current market conditions and recent financial performance of the Bank, we reviewed our model assumptions for Bank Audi. We lowered the growth of assets and deposits for 2012e to 3% and 2% respectively and expect them to gradually pick up reaching 5% in 2013e. We increased lending growth from 7% previously to 12% in 2012e in light of the Bank solid performance in H1/12. Consequently, the estimated loans-to-deposits ratio for 2012e increased from almost 35% to 38% and is expected to reach 39% for 2013e.

Based on our revised model, we expect net profits (group share) to grow by 5% in 2012e and to pick up to 12% in 2013e on the back of i) continued yet moderate balance sheet growth ii) stable interest margins iii) continued non-interest income generation and iv) growth from the Turkish entity taking into account a gradual branch rollout in Turkey over the next few years. Our model takes into account stable efficiencies. As for provisions, we have modeled a significant growth YoY in 2012e following H1/12 results, yet expect them to trend lower starting 2013e given that the Bank has been putting aside significant provisions facing rising uncertainties particularly as visibility is improving in Egypt and Bank Audi began recognizing income since the beginning of the year.

FFA Revised Forecasts

USD millions	H1/11a	H1/12a	FFA Q3/12e	FFA 2012e	FFA 2013e
Assets	29,082	28,790	29,193	29,541	31,019
Deposits	25,268	24,706	25,007	25,257	26,520
Loans	8,566	9,076	9,402	9,620	10,361
Operating Income	468.3	538.8	270.4	1107.6	1201.9
Net Profits from continuing operations	175.8	185.5	92.4	384.6	431.1
Net Profits from continuing operations (Group Share)	170.2	183.1	91.5	379.6	425.6
Diluted EPS from continuing operations	0.47	0.50	0.24	1.01	1.14
BVPS (to common)	5.57	6.01	6.52	6.69	7.10

Source: Bank Audi and FFA Private Bank estimates

Note: Figures for 2012 exclude the sale of LIA which represents approximately USD 0.13 in EPS, reported EPS for H1/12 was USD 0.62

Investment Opinion

We recognize Bank Audi's leadership at navigating through difficult operating conditions and highlight its attractive valuation levels

Bank Audi is the leader among Alpha Banks in terms of assets, deposits, and earnings, has a demonstrated franchise and the confidence of its clients in Lebanon and abroad. In light of difficult operating conditions we notice improving fundamentals that should help shares return to a premium valuation to book once investor concerns regarding key regional operations and earnings slowdown subside. We continue to rate Bank Audi shares at Marketweight although recognize upside potential on valuation in the shorter term and the return to a growth expansion strategy including the branch roll out in Turkey in the medium to longer term.

Recommendation

We reiterate our Marketweight rating on Bank Audi shares with a fair value of USD 7.00 per share down from USD 7.50 previously

Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, our fair value estimate has been revised downward to USD 7.00 per share down from USD 7.50 previously. Our DDM assumes a 15.5% cost of equity and a 3% terminal growth rate. We corroborate our DDM valuation by means of the residual income method as well as historical and comparable P/E and P/B multiples.

BLOM BANK

Q2/12 Consolidated Financial Highlights

Blom Bank's net profits amounted to USD 81.1 million in Q2/12 almost unchanged from USD 81.5 million in Q2/11 although. Blom Bank reported flat earnings in Q2/12 over Q2/11 on account of i) a soft 2.3% growth rate in operating income at USD 174.1 million attributed to a 6% increase in net interest income and 9% decline in non-interest income from flat fees and commission and 24% drop in trading and investment income ii) higher provisions at USD 10.7 million in Q2/12 up from USD 2.4 million in Q2/11 which counterbalanced a USD 4 million reduction in operating expenses translating into an improvement in cost efficiencies with a cost-to-income ratio dropping to 38.5% in Q2/12 down from 41.7% in Q2/11. Basic and diluted EPS was USD 0.37 unchanged from Q2/11. Looking at the first half of 2012, we note net profits and EPS at a respective USD 165.3 million and USD 0.75, up by a respective 1% and 3% from H1/11.

H1/12 Financial Highlights for Operations in Syria and Egypt

In the Syrian market, Blom Bank saw deposit outflows and slower lending activity since the beginning of 2012. Assets, deposits and loans declined by 26%, 23% and 10% in the first half of 2012 to USD 904 million, USD 810 million and USD 255 million respectively. Over the same period, NPLs rose from 2.7% in Q4/11 to almost 8.4% in H1/12. In parallel to this increase, Management has increased provision levels in the Syrian entity to reach USD 20 million by end-June 2012. Net profits in Syria declined by 76 % YoY in H1/12 to USD 2.2 million.

In Egypt, assets and deposits did not see a decline since the beginning of 2011 despite political events. Both indicators increased by 7% and 9% respectively totaling USD 1,512 million and USD 1,236 million respectively, while the size of the loan book remained roughly flat at USD 422 million. The NPL ratio stabilized from in H1/12 at roughly 20%. Net profits amounted to USD 2.5 million in H1/2012 down 38% from H1/12.

Strategy Update

Cautiousness in Syria, improving visibility in Egypt, and growing interest in Iraq

Blom Bank is currently adopting a wait and see attitude in Syria while increasing level of provisioning facing recent developments. In Egypt, the situation is getting back to normal despite the Bank having to cope with a devaluation of the currency and increasing level of NPLs. Blom Bank is currently looking at the Iraqi market.

Strengthening the revenue mix through the enhancements of revenues from non-interest sources

The medium term target for Blom Bank is to reach a balanced breakdown of revenues between net interest income and non-interest income through the enhancement of non-interest activities. To reach this target Management is deploying efforts seeking to increase this portion of revenues by increasing investment activities, brokerage, and asset management. Investment banking activities and the real estate fund in KSA are viewed by Management as providing significant opportunities.

Growing emphasis on lending supported by ample liquidity levels

Management is putting a growing emphasis on expanding its loan portfolio to enhance balance sheet expansion as a way to counterbalance pressures from interest margins on interest income. The loan portfolio grew by 4% YTD in H1/2012 despite softer economic conditions in Lebanon and political developments in regional countries. With a loans-to-deposits ratio at 27.8% by year-end 2011, Blom Bank boasts significant liquidity buffers to comfortably increase lending to the private sector.

Recent News

May 2012: For the financial year 2011, Blom Bank paid dividends to common shareholders the amount of LBP 675 per share (USD 0.45 gross or USD 0.43 net of 5% withholding tax).

February 2012: BlomInvest Saudi Arabia announced the closing of the private placement offering of "BlomInvestMaskan Arabia for Real Estate Development Fund" amounting to USD 75 million. The project aims at building residential units in north and north-west Riyadh in collaboration with Maskan Arabia, the project developer.

FFA Model Assumptions

In light of the current market conditions and recent financial performance, we reviewed our model assumptions for Blom Bank. Based on our revised model, we expect Blom Bank will grow its assets, deposits and loans by 7%, 6% and 7% in 2012e respectively, almost unchanged from our previous assumptions (at a respective 8%,6% and 8%). The loans-to-deposits ratio was maintained at 28% for 2012e and is expected to remain stable in 2013e.

We expect net profits (group share) to grow by 4% in 2012e and to pick up to 9% in 2013e on the back of i) continued yet moderate balance sheet growth, ii)relatively stable interest margins, iii) continued non-interest income generation. Our revised model takes into account cost-efficiencies stabilizing around 35% as well as higher provisions year-on-year in 2012e and 2013e.

FFA Revised Forecasts

USD millions	H1/11a	H1/12a	FFA Q3/12e	FFA 2012e	FFA 2013e
Assets	23,105	23,825	24,436	24,813	26,431
Deposits	20,446	20,864	21,135	21,451	22,738
Loans	5,553	5,808	5,889	5,982	6,364
Operating Income	345.2	395.5	184.9	808.0	883.0
Net Profits	163.6	165.3	83.8	341.7	376.6
Net Profits (Group Share)	159.2	163.8	81.7	335.8	367.2
Diluted EPS	0.73	0.75	0.36	1.52	1.63
BVPS (to common)	7.37	8.15	9.25	9.48	10.62

Source: Blom Bank and FFA Private Bank estimates

Investment Opinion

We view Blom Bank's higher returns and solid liquidity levels as a reflection of a prudent management team and see scope for dividends to grow over time on account of lower than average payouts

We recognize Blom Bank's solid positioning in its domestic market. We like the firm's superior profitability and return ratios in Lebanon relative to its domestic peers despite sizeable liquidity buffers. In the short term, we look to the prudent management team to maintain asset quality in light of difficult operations in key regional markets.

Recommendation

We reiterate our Overweight rating on Blom Bank shares with a fair value at USD 10.00 per share down from USD 11.00 previously

Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, our fair value estimate has been revised downward to USD 10.00 per share down from USD 11.00 previously. Our DDM assumes a 15.5% cost of equity and a 3% terminal growth rate. We corroborate our DDM valuation by means of the residual income method as well as historical and comparable P/E and P/B multiples.

BYBLOS BANK

Q2/12 Consolidated Financial Highlights

Byblos Bank's net profits amounted to USD 41.7 million in Q2/12 roughly flat from USD 41.9 million in Q2/11 although. This year on year stagnation in earnings in Q2/12 over Q2/11 can be attributed to i) roughly flat operating income at USD 109.5 million on the back of 6% decline in net interest income and 7% growth in non-interest income ii) improvement in cost efficiencies with a cost-to-income ratio at 48.2% in Q2/12 down from 52.5% in Q2/11 which was mostly offset by higher provisions at USD 5.6 million in Q2/12 up from USD 4.3 million in Q2/11 and higher income tax at USD 9.4 million in Q2/12 up from USD 6.4 million in Q2/11. Basic and diluted EPS was USD 0.06 unchanged from Q2/11. Net profits and EPS for the first half of 2012 stood at a respective USD 80.4 million and USD 0.10, flat from the corresponding period of previous year.

H1/12 Financial Highlights for Operations in Syria

Byblos Bank's Syrian operations saw a decrease in balance sheet indicators by 14%, 9% and 34% for assets, deposits and loans during the first half of 2012 to a respective USD 733 million, USD 624 million and USD 284 million. Profits were down YoY to USD 0.6 million in H1/12 from USD 1.9 million in H1/11 as bottom line was impacted by significantly higher provision levels to USD 17 million in H1/12 compared to USD 1.2 million in H1/11. NPLs rose to 19.3% in June 2012 from 4.3% by year-end 2011.

Strategy

Conservative approach to growth regionally amid political turbulences and continued interest in Iraq

Byblos Bank will maintain its conservative approach to growth in Syria where the Bank has suspended its expansion strategy and remained focused on closely monitoring its loan portfolio. According to Management report Byblos Bank Syria will follow cautious crisis-management measures as action plans will be studied according to changes in market conditions. In parallel Byblos Bank will continue to look at any interesting market that could enhance growth. In this framework, Management is currently focusing on Iraq, an under banked market offering an attractive growth potential where Byblos Bank opened its third branch in the Iraqi city of Basra earlier in March. Byblos Bank established a presence in Iraq in May 2007 through a branch in Erbil and has a branch in Baghdad (February 2010). We expect Management will maintain its focus on the Iraqi market and will expand operations depending on the Bank's performance and available opportunities.

Liquidity accumulation strategy amidst an uncertain operating environment

Byblos Bank has been adopting a liquidity accumulation strategy in the wake of softer economic conditions and regional developments in order to assess the heightened geopolitical risks and revaluate attractive investment avenues. The Bank boasts ample liquidity levels as highlighted by i) a loans-to-deposits ratio at 31% in H1/12 ii) an immediate liquidity ratio (cash + due from banks / deposits) at 47% in H1/12.

Recent news

April 2012: For the financial year 2011, Byblos Bank paid dividends to common shareholders the amount of LBP 200 per share (USD 0.132 gross or USD 0.126 net of 5% withholding tax).

March 2012: Opening of a branch in Basra, Iraq. The Basra branch is the third to open in Iraq following earlier openings in Irbil (the regional capital of Kurdistan) and Baghdad.

February 2012: Opening of a branch in Komitas, Armenia. The Komitas branch is the fourth to open in Armenia, following earlier openings in Amiryan, Malatia and Vanadzor.

FFA Model Assumptions

In light of the current market conditions and recent financial performance, we reviewed our model assumptions for Byblos Bank. We expect Byblos Bank will grow its assets, deposits and loans by a respective 4%, 6% and 6% in 2012e (slightly down from 8% in our previous assumptions) while expectations for 2013e standing at a respective 7%, 6% and 8%. The loans- to-deposits ratio is expected to gain some points from roughly 31% to 32% in 2013e.

We expect profits (group share) to remain roughly flat in 2012e and to grow by 3% in 2013e on the back of i) continued yet moderate balance sheet growth, ii) relatively stable interest margins, iii) continued non-interest income generation. Our revised model takes into account a cost-to-income in the 43%-45% range and a gradual increase in provision levels YoY for 2012e and 2013e.

FFA Revised Forecasts

USD millions	H1/11a	H1/12a	FFA Q3/12e	FFA 2012e	FFA 2013e
Assets	16,544	16,586	16,982	17,205	18,375
Deposits	12,595	13,270	13,437	13,606	14,415
Loans	3,924	4,094	4,195	4,247	4,575
Operating Income	221.0	228.2	120.4	484.5	517.8
Net Profits	80.4	80.4	44.5	180.8	187.3
Net Profits (Group Share)	76.8	77.6	42.5	173.6	179.1
Diluted EPS	0.10	0.10	0.06	0.24	0.25
BVPS (to common)	1.90	1.90	2.16	2.20	2.28

Source: Byblos Bank and FFA Private Bank estimates

Investment Opinion

While we like Byblos Bank's solid domestic retail franchise and growth in earnings with strong risk management practices, we believe additional value could be generated for investors as visibility and cost-efficiencies improve
We recognize Byblos Bank's position in its domestic retail market and solid fundamentals benefiting from sizeable liquidity buffers, strong capitalization and superior asset/liability management practices, a validation of management's risk management practices although at the detriment to profitability ratios. We also recognize the firm's leadership at better managing its asset liability mismatch with the issuance of costlier longer term liabilities. We believe Byblos Bank's shares could generate more value once the firm gains visibility in its outlook and redeploys capital to create additional shareholder value by way of expansion, acquisition, or return of capital.

Recommendation

We reiterate our Marketweight rating on Byblos Bank shares with a fair value of USD 1.60 per share down from USD 1.80 previously

Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, our fair value estimate has been revised downward to USD 1.60 per share down from USD 1.80 previously. Our DDM assumes a 15.5% cost of equity and a 3% terminal growth rate. We corroborate our DDM valuation by means of the residual income method as well as historical and comparable P/E and P/B multiples.